## BRIEF IN SUPPORT OF THE PETITION FOR CERTIORARI.

### THE QUESTIONS PRESENTED.

The questions presented by the petition for certiorari are:

1. Is one a "shareholder" in a corporation, authorized to bring a stockholder's derivative action in a Court of the United States, within the meaning of Federal Rule of Civil Procedure 23 (b), and within the meaning of the Statute Law of the State of Georgia, if his only interest in the corporation at the time of the institution of his suit and at the time of the transactions complained of was that of residuary legatee under the will of a stockholder, which, among other property, disposes of such stock as a part of the residuum and not by specific designation, where at the time of the institution of the suit there are outstanding debts due by the estate, and the estate has not been wound up, where no distribution in kind has been made of the stocks, where the Executor has power to sell the stocks for payment of the debts of the estate, and where the residuary legatee has never been in a position to demand or require a distribution of the residuary?

2. Was the complaint so defective as to authorize dismissal by the trial Court in that it did not aver under oath that the action was not a collusive one as required by Rule 23 (b) (2) of the Federal Rules of Civil Procedure?

### RULE 23 (b) OF THE FEDERAL RULES OF CIVIL PROCEDURE.

Inasmuch as both questions presented by the petition for certiorari involve construction of Rule 23 (b), it is well to quote that rule in its entirety:

> "In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the asso-

ciation refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction."

QUESTION 1.

By answering question one in the negative, the District Court held that the plaintiff was not a shareholder at the time of the transactions of which he complained. The Circuit Court of Appeals, by reversing the judgment of the District Court, answered the question in the affirmative. We respectfully submit that the negative answer of the District Court was the correct answer. Under the facts stated in the question, the plaintiff was not a "shareholder" and therefore could not have been a shareholder at the time of the transaction of which he complained. Therefore, his action was fatally defective.

**The decision of the Circuit Court of Appeals is in conflict with the decision of another Circuit Court of Appeals on the same matter.**

In the case of Whitaker et al. v. Whitaker Iron Co. et al., 238 Fed. 980, the District Court of the United States of the Northern District of West Virginia held:

> "General legatees of a testator, who owned stock of a corporation, do not by devolution take title to such stock, which in the absence of a statute changing the common law rule, or special provision otherwise in the will, the Executor has full power to dispose of, and such legatees cannot, as stockholders, maintain a suit against the corporation and others, under equity rule 27, as to transactions occurring prior to distribution of the estate" (7th Headnote).

The decision of the District Court was affirmed by the Circuit Court of Appeals for the Fourth Circuit, sub nomine, Whitaker et al. v. Whitaker Iron Company et al., 249 Federal 531. The first headnote of the opinion of the Circuit Court of Appeals for the Fourth Circuit is as follows:

> "By his will a testator empowered his executors to convert all his property into cash at any time, except certain stock in a corporation, which they were to hold in trust for the benefit of his wife until her death, when it was to become a part of his residuary estate, which after payment of special bequests, was to be equally divided between his children or their representatives, taking into account advances made them. Held, that the legatees did not by devolution take title to the stock on the death of his wife while it remained in the hands of the executors, who had power to sell the same, and that they could not maintain a stockholder's suit against the corporation and others."

At page 536 of the opinion, the Circuit Court of Appeals for the Fourth Circuit said:

> "Thus it will be observed that appellants did not own a single share of stock in the Whitaker Iron Company by gift or purchase, and, as we have stated, none of these shares of stock devolved upon either of them by operation of law."

The Supreme Court denied certiorari (248 U. S. 564).

This case was not mentioned by the Fifth Circuit Court of Appeals in its opinion in the case at bar. It was neither cited nor distinguished, although it was cited in our original brief and specific attention was called to it in our motion for rehearing. Thus, we have different rules of law in the Fourth Circuit and the Fifth Circuit. The true rule can only be determined by Your Honors.

The subject of stockholders' derivative actions has been the occasion of much legislation and many judicial opinions. The subject was deemed of sufficient importance by this Court to be treated in one of the Rules of Federal Procedure when those rules were adopted by Your Honors at a comparatively recent date—1938. We most respectfully submit that a typical case for the grant of a petition for certiorari is presented when the construction of that rule is involved.

Most particularly is that true when, as here, one Circuit Court of Appeals has rendered a decision in conflict with the decision of another Circuit Court of Appeals in the construction of the same rule or its antecedent rule.

There is no statute in Georgia changing the common-law rule referred to by the Court in the Whitaker case, supra. Under the Georgia statute, title to all property of a decedent, except realty, vests in the personal representative of his estate for the benefit of the heirs and creditors (Civil Code of Georgia [1933], Section 113-901).

**In so far as the decision of the Circuit Court of Appeals attempts to construe the Georgia Statute, it has decided an important question of local law in a way probably in conflict with applicable local decisions.**

**In deciding that respondent was a shareholder within the meaning of Federal Rule of Civil Procedure 23 (b), the Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court. Those decisions of this Court which pertain to the question are contrary to the decision of the Circuit Court of Appeals.**

The question of the right of one claiming to be a shareholder of a corporation to bring a derivative action in a Federal Court is an important question of Federal law. If it is the law that the owner of an "equitable interest" in stock of a corporation is a shareholder in a corporation within the meaning of the Federal Rules, the doors of the

Federal Courts will be opened to many who are not, in the usually accepted meaning of the term, "shareholders" in a corporation.

In the case of Hawes v. Oakland, 104 U. S. 450, this Court held that in order for one to maintain a stockholder's derivative action, it must be made to appear "that the **ownership** of the stock was **vested** in him at the time of the transactions of which he complains, or was thereafter transferred to him by operation of law." (Emphasis ours.)

Hawes v. Oakland was decided by this Court at the October term, 1881. Immediately thereafter (January, 1882), Equity Rule 94 was promulgated so as to effectuate the decision in Hawes v. Oakland. (A Federal Equity Suit—Simkins—Second Edition, page 240.)

Equity Rule 94 provided:

> "Every bill brought by one or more stockholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a **shareholder** at the time of the transaction of which he complains, or that his share had devolved upon him since by operation of law, and that the suit is not a collusive one to confer on a Court of the United States jurisdiction of a case of which it would not otherwise have cognizance. . . ." (Emphasis ours.)

The meaning of the word "shareholder" in this rule must be determined in the light of the case which gave birth to the rule. The Court had said a very short time prior to the promulgation of the rule that a complainant in a derivative action must show "that the ownership of the stock was vested in him at the time of the transactions of which he complains." Therefore, the word "shareholder" in the rule means one in whom the **ownership** of stock is **vested.**

Equity Rule 94 remained unchanged until November 3, 1912, when new Equity Rules were promulgated. The subject of stockholders' bills was embraced in Rule 27. The portion of Rule 94 heretofore quoted was continued totidem verdis as a part of Equity Rule 27 (28 U. S. C. A., Section 723, App. page 808).

Thus the rule remained until the adoption of the Federal Rules of Civil Procedure which became effective September 16, 1938.

The subject of stockholders' suits is covered in these new rules in Rule 23 (b) (supra). While the language of this rule differs somewhat from old Rules 27 and 94, there still remains the requirement that the plaintiff be a **shareholder** at the time of the transaction of which he complains.

The Georgia Statute (Section 22-711 of the Code of 1933) provides:

> "A minority stockholder may proceed in equity in behalf of himself and other stockholders for fraud or acts ultra vires against a corporation, its officers and those participating therein, when he and they are injured thereby. But there must be shown— . . . (6) That the petitioner was a stockholder at the time of the transaction of which he complains, or that his shares have devolved on him since by operation of law."

This statute is, too, a lineal descendant of Hawes v. Oakland, supra. The statute appeared first in the Code of 1895, as Section 1860. It did not appear in any Code prior to 1895. (There were four, those of 1863, 1868, 1873, and 1882.) It was codified from the case of Alexander v. Searcy, 81 Ga. 536 (decided in 1888). In that case the Supreme Court of Georgia said:

> "The weight of authority seems to be that a person who did not **own stock** at the time of the transactions complained of, cannot complain or bring a suit to have

> them declared illegal. In the case of Hawes v. Oakland, supra, it is said that the bill must allege that the complainant was a shareholder at the time of the transaction of which he complains, or that his shares have devolved on him since by operation of law." (Emphasis ours.)

The Georgia Court alluded also to the case of Dimpfell v. Ohio and Miss. R. Co., 110 U. S. 209, in which case Mr. Justice Field said, in speaking of the complainant's efforts to induce the directors or stockholders of the corporation to begin suit:

> "The cause of his failure should be stated with particularity in his bill of complaint, accompanied with an allegation that he was a stockholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law."
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> (81 Ga., at page 551.)

When the compilers of the Georgia Code of 1895, the first Code adopted by the General Assembly after the pronouncement of this decision, codified it, they used the word "stockholders."

> "Where a section of the Code has been codified from a decision of this Court, it will be construed in the light of the source from which it came, unless the language of the section imperatively demands a different construction."
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> Calhoun v. Little, 106 Ga. 336 (3).

Applying this rule of statutory construction, "stockholder" means a person who owns stock, not a person having a contingent equitable interest in stock.

The Georgia Supreme Court has not even held that one holding a **perfect equitable title** to stock is a stockholder

within the meaning of the Georgia statute. In Nussbaum v. Nussbaum, 186 Ga. 773, at page 780, the Supreme Court of Georgia said:

> "**Indulging a second assumption,** to-wit, that a perfect equitable title to stock, irrespective of the name in which it appears on the books of the corporation, **may** be sufficient ownership to qualify one to participate in a stockholder's suit of this character, still it is not made to appear from the allegation quoted above that Herbert H. Nussbaum holds the perfect equitable title to this C. A. Miller stock." (Emphasis ours.)

QUESTION 2.

**Was the Complaint So Defective as to Authorize Dismissal by the Trial Court in That It Did Not Aver Under Oath That the Action Was Not a Collusive One as Required by Rule 23 (b) (2) of the Federal Rules of Civil Procedure?**

The rule distinctly and succinctly provides that a complaint of this nature shall be verified by oath and shall aver that the action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

This portion of the rule, too, seems to have been originally derived from the decision of this Court in Hawes v. Oakland, supra. At page 461 of that opinion, the Court said that the allegation "that the suit is not a collusive one to confer on a Court of the United States jurisdiction in a case of which it would otherwise have no cognizance," should be in the bill, which should be verified by affidavit.

Substantially this language was immediately thereafter embodied in Equity Rule 94.

The reason for the rule is demonstrated by the facts of the case at bar. The District Court of the United States for the Middle District of Georgia would not have had jurisdiction of a **primary** or **direct** action brought by Cotton States Fertilizer Company, a Georgia corporation, against

its officers and directors, Clay and O'Shaughnessey, both residents and citizens of Georgia. That District Court might entertain a secondary or derivative action brought by a stockholder, not a citizen of the State of Georgia (the requisite jurisdictional amount appearing). But at the threshold of the Federal Court, the plaintiff must allege under oath that the action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

The reasons for the rule are apparent from facts shown in the record in this case.

The will of Joel Hurt bequeathed one-sixth of the residuary of his estate to each of six persons, one of whom was the respondent. Five of the others were sisters of the respondent (R. page 224). They reside in the State of Georgia. If they had been plaintiffs or co-plaintiffs, the Federal Court would have lost jurisdiction.

Was the respondent selected by the family as the sole plaintiff so as to confer jurisdiction on a Court of the United States?

The rule requires that that question be answered at the time of the institution of the suit by a compliance with the terms of the rule, by an averment under oath that the action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

The Circuit Court of Appeals of the Fifth Circuit has held in the case of Moore et al. v. Panama Ice & Fish Co., 81 Fed. (2d) 837:

> "Stockholder's bill against directors of corporation which failed to contain verified allegation that suit was not collusive one to confer jurisdiction on Federal Court in case of which it would not otherwise have cognizance **held** properly dismissed. (Equity Rule 27, 28 U. S. C. A., following section 723.)" (Headnote 6.)

At page 839 of the opinion the Court (Judges Sibley, Hutcheson, and Walker), speaking through Judge Walker, said:

> "There was no attempt to comply with Equity Rule 27, 28 U. S. C. A., following section 723. Where a stockholders' bill fails to comply with the **mandatory provisions of that rule,** it should be dismissed. Laughner v. Schell (C. C. A.), 260 Fed. 396; Delaware and Hudson Co. v. Albany and Susquehanna R. Co., 213 U. S. 435, 29 S. Ct. 540, 53 L. Ed. 862." (Emphasis ours.)

The attention of the Fifth Circuit Court of Appeals was called to its former decision in our original brief (pages 14, 15); in our supplemental brief (page 8); and in our motion for rehearing (page 9). It was not mentioned in the opinion of the Court. No opinion was written by the Court in denying the motion for rehearing.

Your Honors have provided in your rules as indicative of the character of reasons which will be considered by the Court in the grant of the writ of certiorari, a case where a Circuit Court of Appeals has rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter [Rule 38 (5b)].

The case presented falls within the spirit and letter of that rule.

While Moore v. Panama Ice & Fish Company, supra, was decided by the same Court which decided the case at bar, the personnel of the Court sitting was entirely different. In the Moore case, Judges Sibley, Hutcheson, and Walker, were sitting. Judge Walker has died. Judges Sibley and Hutcheson are still members of the Court. Neither participated in the decision of the case at bar. The Court which decided our case was composed of Judges Holmes, Waller, and Lee, neither of whom participated in the decision of the Moore case.

So, we come within the spirit of Rule 38 (5b). But, we come within the letter of it, too. The Circuit Court of Appeals of the Third Circuit in Laughner v. Schell, 260 Fed. 396, held:

> "Where a stockholder, a citizen of California, brought a bill against a corporation and its officers, citizens of Pennsylvania, to require them to account to the corporation for certain commissions paid, the cause of action and prayer for relief constituting in substance a stockholder's bill merely, the District Court has no jurisdiction on the ground of diversity of citizenship, where complainant has not complied with the mandatory direction of Equity Rule 27, requiring a stockholder's bill to contain a verified allegation that the suit is not a collusive one to confer jurisdiction on the Federal Court in a case of which it would not otherwise have cognizance."

In the Moore case, the Fifth Circuit Court of Appeals followed Laughner v. Schell (81 Fed. [2d], at page 839).

In the case at bar, the Fifth Circuit Court of Appeals failed to mention either its Moore case, or the Third Circuit's Laughner v. Schell.

In the case of Wathen v. Jackson Oil and Refining Company, 235 U. S. 635, this Court held:

> "Under Equity Rule 27 (formerly 94) **in order to confer jurisdiction** upon a Federal Court of a suit by a stockholder to enforce a remedy belonging to the corporation, the bill must allege **not only that the suit is not a collusive one for the purpose of conferring jurisdiction**, but that unsuccessful efforts have been made to induce the corporation to bring the suit or the reasons for not making such efforts." (Emphasis ours.)

## CONCLUSION.

There are two cases which stand out as the leading cases on the law of technical stockholders' suits in the Federal Courts, one which may be said to have originated this form of suit in such Courts, and the other to have expounded and confirmed it with proper limitations. The latter case, Hawes v. Oakland, supra, has been cited and considered in this brief. The former, Dodge v. Woolsey, 18 How. (U. S.) 331, 15 L. Ed. 401 (1856), should be considered.

A brief consideration of it will suffice to show that if the decision of the Fifth Circuit Court of Appeals in the case at bar is permitted to stand, Your Honors will have sanctioned an extension of the doctrine of Dodge v. Woolsey, an extension which was not contemplated by your rules—either old rules 94 and 27, or the present Rule 23 (b).

Dodge v. Woolsey was a suit in chancery, brought by Woolsey, a citizen of Connecticut, and the **owner** of thirty shares in a Cleveland, Ohio, bank, a corporate resident of Ohio, seeking to enjoin the collection of a tax assessed by the State of Ohio on the bank.

It was urged that the suit had been improperly brought in the Court of the United States for the District of Ohio, because it was a contrivance to create a jurisdiction where none fairly existed, by substituting an individual stockholder in place of the bank as complainant, and making the directors defendants; the stockholder being made complainant because he was a citizen of the State of Connecticut and the directors being made defendants to give countenance to his suit.

The Court ruled:

> **"A stockholder in a corporation has a remedy in chancery against the directors, to prevent them from doing acts which would amount to a violation of the charter, or to prevent any misapplication of their capital or profits which might lessen the value of the**

shares, if the acts intended to be done amount to what is called in law a breach of trust or duty.

"So, also, a stockholder has a remedy against individuals, in whatever character they profess to act, if the subject of complaint is an imputed violation of a corporate franchise, or the denial of a right growing out of it, for which there is not an adequate remedy at law.

"Therefore, where the directors of a bank refused to take the proper measures to resist the collection of a tax, which they themselves believed to have been imposed upon them in violation of their charter, this refusal amounted to what is termed in law a breach of trust, a stockholder has a right to file a bill in chancery asking for such remedy as the case might require.

"If the stockholder be a resident of another State than that in which the bank and persons attempting to violate its charter, or commit a breach of trust or duty have their domicile, he may file his bill in the courts of the United States. He has this right under the constitution and laws of the United States."

Dodge v. Woolsey, 18 How., page 331.

The Court will notice the repeated use of the word "stockholder" in the language quoted from the decision of the Court.

The opinion of Mr. Justice Wayne reviews several English and American cases, and the Justice summarizes:

"The result of the cases is well stated in Angell & Ames, paragraphs 391, 393. 'In cases where the legal remedy against a corporation is inadequate, a court of equity will interfere, is well settled, and there are cases in which a bill in equity will lie against a corporation **by one of its members**.' 'Though the result of the authorities clearly is, that in a corporation, when acting within the scope of and in obedience to the provisions of its constitution, the will of the majority, duly expressed at a legally constituted meeting must

govern; yet beyond the limits of the act of incorporation, the will of the majority cannot make an act valid; and the powers of a Court of equity may be put in motion at the instance of a single **shareholder,** if he can show that the corporations are employing their statutory powers for the accomplishment of purposes not within the scope of their institution.' " (Emphasis ours.)

As a result of Dodge v. Woolsey and of cases following it, the doctrine was established that a **stockholder,** not a resident of the State of the residence of the corporation in which he owns **stock,** may sue that corporation and its directors to prevent misapplication of the assets of the corporation which might lessen the value of **his shares.**

So the rules of this Court have for sixty-four years provided. But—your decisions and rules have never extended this doctrine so as to apply it to one not a stockholder in a corporation, so as to authorize a suit on the ground of diversity of citizenship at the behest of one not a stockholder, but merely the owner of an "equitable interest" in stock. Such a person is not a **member** of the corporation. He is not a stockholder in the corporation. Your decisions and your rules have never recognized one situated as the respondent is as having any standing based on diversity of citizenship in a Court of Equity of the United States.

This case presents "a contrivance to create a jurisdiction, where none fairly exists," by substituting in place of Cotton States Fertilizer Company as complainant, not even an "individual stockholder" of that Company, but one having an "equitable interest" in its stock.

Respectfully submitted,

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